MEMORANDUM FOR: DCI

D.

Attached is a slightly revised grain paper.

Maurice reports that the changes are editorial.

I will review as well and advise you if I catch anything new.

Keith

Date 14 July 82

FORM 5-75 101 USE PREVIOUS EDITIONS

THE WHITE HOUSE
WASHINGTON

Executive Registry
82-16811/4

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 7-14-82 NUMBER: 077380CA DUE BY:

SUBJECT: FULL CABINET MEETING - JULY 15, 2:00 PM
CABINET ROOM

	ACTION	FYI
ALL CABINET MEMBERS	☑	☐
Vice President	☐	☐
State	☐	☐
Treasury	☐	☐
Defense	☐	☐
Attorney General	☐	☐
Interior	☐	☐
Agriculture	☐	☐
Commerce	☐	☐
Labor	☐	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☐	☐
Energy	☐	☐
Education	☐	☐
Counsellor	☐	☐
OMB	☐	☐
CIA	☐	☐
UN	☐	☐
USTR	☐	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
	☐	☐
	☐	☐

	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☑	☐
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
	☐	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
	☐	☐
CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: Attached is the revised paper on U.S.-Soviet Long-Term Grain Agreement/CM242, which incorporates comments received by interested departments, for the July 15 Full Cabinet Meeting.

Not referred to USDA. Waiver applies.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs

☑ Becky Norton Dunlop
Director, Office of
Cabinet Affairs

ISSUE PAPER

U.S.-U.S.S.R. GRAIN AGREEMENT

Issue

The current U.S.-U.S.S.R. Grain Agreement will expire on September 30, 1982. The Administration must decide whether it wants a formal arrangement (and, if so, what kind) to govern U.S.-U.S.S.R. grain trade after September 30.

I. Background

U.S.-U.S.S.R. Grain Trade Prior to 1975. An unfavorable climate, poor soil, backward technology, and an extremely inefficient agricultural system make periodic crop failures in the Soviet Union a virtual certainty. As a result, the Soviets have, during the last twenty years, imported increasing amounts of grain to accommodate their domestic needs.

Soviet purchases from the U.S. were relatively modest until 1972, when the prospect of a major crop failure prompted them to buy, over a two to three month period, 19 million metric tons (mmt) of U.S. grain, including one-fourth of the total U.S. wheat crop. The Soviets made their purchases quietly and early, before prices adjusted to the sudden increase in demand. The Soviets also were able to capitalize on USDA's wheat export subsidy program and a recently negotiated credit arrangement. These circumstances, as well as the domestic market disruption caused by the massive grain purchases, led critics to label the U.S. sales as the "great Soviet grain robbery."

The U.S.-U.S.S.R. Grain Agreement. The summer of 1975 brought new reports of a looming Soviet crop failure. These reports, coupled with the desire to avoid a repeat of the 1972 scenario, prompted the Ford Administration to suspend grain sales to the Soviet Union until an arrangement could be worked out that would prevent Soviet disruption of U.S. domestic markets and guarantee U.S. farmers a reasonable share of the Soviet market.

The ensuing negotiations with the Soviet Union produced an agreement with the following provisions:

- The Soviets agreed to purchase 6 mmt of U.S. wheat and corn, in approximately equal proportions, during each of the five years covered by the agreement;

- The Soviets can purchase up to 2 mmt more of U.S. grain during any year without consultations with the U.S.;

- The U.S. agreed not to embargo exports of up to 8 mmt of grain to the Soviet Union;

- The Soviets are required to consult with the U.S. (to determine a higher supply level) before buying more than 8 mmt of grain in any given year;

- There is an escape clause for the U.S. in the event of a major U.S. supply shortage;

- Soviet purchases must be made at prevailing market prices and in accordance with normal commercial terms.

- The Soviets agreed to ship the grain under the terms of the U.S.-U.S.S.R. Maritime Agreement;

- The Soviets are required to space their grain purchases and shipments as evenly as possible over each 12-month period.

Since the agreement, there has been greater stability in world grain trade and in Soviet purchasing patterns. Under the agreement, the U.S. has expanded its share of the Soviet market (see Appendix). Over this period, Soviet demands for grain have increased more rapidly than their production, resulting in a higher level of Soviet grain imports.

The Soviet Grain Embargo of 1980. On January 4, 1980, in response to the Soviet military invasion of Afghanistan, President Carter cancelled contracts for the sale of 13.5 mmt of U.S. corn and wheat to the Soviet Union. The U.S. also denied the Soviets access to an additional 3.5 mmt of grain which had been offered to, but not yet purchased by, the Soviets. Finally, shipments of soybeans, broilers, and some other agricultural products were halted.

The Soviets were able to minimize the effects of the embargo by drawing down their grain stocks and by increasing grain, soybean, rice, flour, and meat imports from Argentina, Canada, Australia, and the European Economic Community.

The Soviets have since entered into new long-term purchasing agreements with Argentina, Brazil, Canada, Hungary, and Thailand, in an attempt to diversify their sources of supply, resulting in a declining share of the Soviet market for U.S. farmers.

In April 1981, President Reagan lifted the Soviet grain embargo. This was followed by an agreement in August to extend the expiring U.S.-U.S.S.R. grain accord for an additional year, through September 30, 1982. In October 1981, the U.S. offered the Soviets an additional 15 mmt of grain, raising to 23 mmt the amount of U.S. grain available to the Soviets during fiscal year 1982. To date, the Soviets have purchased a total of 13.9 mmt of U.S. wheat and corn.

U.S. Sanctions Against the Soviets in the Aftermath of the Polish Declaration of Martial Law. Discussions concerning negotiation of a new U.S.-U.S.S.R. long-term grain agreement were under way within the Administration when the Polish government declared a state of martial law in December 1981. When the Soviet Union failed to respond to U.S. urgings to help restore basic human rights in Poland, the President announced a number of sanctions against the Soviets, including postponement of negotiations on a new grain agreement and suspension of negotiations on a new maritime agreement.

II. Discussion

Soviet Import Demands. Soviet grain production has declined sharply during the past three years, after more than a decade of steady growth. Following a record crop of 237 mmt in 1978, the Soviet harvest fell to 179 mmt in 1979, 189 mmt in 1980, and reportedly to 158 mmt in 1981, nearly one-third below target. To avoid massive shortages, the Soviets have imported more than 100 mmt of grain since June 1979. During the marketing year ending this June, Moscow is expected to import a record 45 mmt of grain.

Soviet hard-currency outlays this year for all agricultural commodities -- including grain, other feedstuffs, meat, sugar, and vegetable oil -- will probably reach some $12 billion, up about $1 billion from last year, and a sharp increase from the roughly $8 billion spent in 1980. Altogether, food imports now account for roughly 40 percent of total Soviet hard-currency purchases.

Even with a strong recovery in domestic grain production, Moscow will continue to import large amounts of grain, an estimated 45 mmt of grain during the next marketing year (July 1982-June 1983). The ultimate level of Soviet grain imports during the next marketing year will depend on:

- o The size of the 1982 Soviet grain crop. USDA recently reduced its projection for the 1982 Soviet grain crop from 185 to 170 mmt;
- o The extent to which the Soviets decide to maintain or expand livestock inventories;
- o Hard-currency constraints. Increasing Soviet hard-currency constraints or a decision by Western bankers to curtail short-term credits could hamper Moscow's import intentions;
- o U.S.-U.S.S.R. trading relations;
- o The extent to which the Soviets will allow increased dependence on imported grains; and
- o Soviet port capacity. Currently Soviet grain import capacity is 45-50 mmt per year.

Soviet officials recently announced ambitious production goals for grain and livestock for the remainder of the 1980s. They also expressed their intention to reduce imports of foodstuffs from capitalist countries. The history of Soviet agriculture, however, suggests that achieving increased livestock production goals will be extremely difficult if the Soviets reduce grain imports.

<u>U.S.-U.S.S.R. Grain Agreement in the Context of the World Grain Market</u>. It is doubtful that a long-term grain agreement between the Soviet Union and the United States would have much effect on the total U.S. share of world grain trade during the next marketing year. However, the existence or absence of such an agreement is likely to have a significant impact on world grain trading patterns in future years. If, by failing to negotiate a formal trading arrangement, the Soviets were discouraged from satisfying their import demands in the U.S. market, they would have to seek new sources of supply. The prospect of servicing a consistently large buyer, such as the Soviet Union, would prompt other exporting countries to further increase their production. (Since the 1980 Soviet grain embargo, Argentina and Canada have increased their grain production by roughly 25 percent.) This increased production would compete with U.S. grain in world markets, reducing the U.S. share of the growth in global grain trade.

U.S. Foreign Policy Considerations. The U.S. is pursuing, and encouraging its allies to pursue, a general policy of economic restraint with the U.S.S.R., based upon fair burden sharing in the West. A government-to-government agreement, especially one perceived as newly-negotiated, that promotes grain exports, would be regarded as an exception to that policy.

More specifically, negotiations with the Soviets would signal an end to one of the President's measures against the U.S.S.R. in response to the Poland crisis, undercutting the general package of Poland-related sanctions, and implying that the situation there has improved and that the U.S. is prepared to adopt a "business as usual" stance. The Soviets could be expected to promote this interpretation vigorously.

Resuming negotiations would conflict with the decision to extend extraterritorially sanctions on oil and gas equipment and technology. In the absence of real changes in Poland, resuming negotiations would undermine U.S. credibility on burden sharing and U.S. efforts to induce its allies to exercise restraint in credit and trade arrangements with the U.S.S.R.

U.S. Domestic Considerations. The U.S. farm sector is experiencing serious economic hardships due to over-abundant grain supplies, high interest rates, and a cost/price squeeze. Pressure is being applied on the Administration to provide various forms of assistance for farmers, including paid land diversions, export subsidies, increased food assistance, and higher price supports.

The negotiation of a new long-term U.S.-U.S.S.R. grain agreement that guarantees U.S. farmers higher minimum sales to the Soviet Union would be viewed by the agricultural community as a positive step in U.S.-Soviet grain trade and as a demonstration of the Administration's commitment to the agricultural sector. It would be perceived by the farm community as consistent with the central feature of the Administration's farm policy -- increasing agricultural exports. Farmers regard the U.S.-Soviet grain agreement issue as the litmus test of the Administration's commitment to the agricultural sector.

The U.S. maritime industry and labor share a common concern over the arrangements for shipping grain from the U.S. to the Soviet Union. In the absence of a new U.S.-U.S.S.R. maritime agreement, U.S.-flag vessels would be effectively precluded from participation in carrying grain to the U.S.S.R. Such a development could have an adverse impact on the cooperation of U.S. maritime labor in implementing any grain agreement.

III. Options

Option 1: Allow the existing U.S.-U.S.S.R. grain agreement to expire without providing for any formal agricultural trading arrangement between the two countries after September 30, 1982.

Advantages:

- o Would be consistent with the President's policy of postponing negotiations on a new long-term grain agreement with the Soviets until there were improvements in the Polish situation.

- o Could be presented as the Administration's attempt to reduce government intervention in the international marketing of U.S. agricultural products.

- o Would end the no-embargo guarantee which gives the Soviets special treatment not accorded to other buyers, and limits the President's foreign policy flexibility.

- o Would be most consistent with our overall Soviet policy and with the recent decision on the pipeline.

Disadvantages:

- o Would give the Soviets unrestricted access to the U.S. grain market and could lead to disruption of the U.S. grain market if the Soviets were to resume their erratic purchasing behavior of the early 1970s.

- o Farmers would view lack of an agreement as eliminating their chances for maximizing their share of grain sales to the Soviet Union, and this would be perceived as undermining the President's commitment to help increase agricultural exports.

- o Could lead to the lowest level of U.S. grain exports under any of the options, and thus increase federal outlays for agricultural price support and production control programs.

- o Would eliminate one more ongoing U.S.-U.S.S.R. tie, and could affect the atmosphere of the upcoming U.S.-U.S.S.R. summit.

Option 2: Extend the existing U.S.-U.S.S.R. grain agreement for one year.

Advantages:

- Would maintain a formal trading arrangement that would assure U.S. farmers of some access to the Soviet market and insulate domestic users from possible Soviet disruption of U.S. markets.
- Would continue the status quo, thereby blunting the charge that the U.S. was making a concession to the Soviets in the absence of an improvement in the Polish situation.
- Would allow for a more positive trade atmosphere with the Soviets than there would be in the absence of an agreement, and thus would leave open the possibility of entering into negotiations on a new long-term grain agreement subsequent to an improvement in the Polish situation.

Disadvantages:

- Would be perceived by U.S. farmers as harming their chances for maximizing their share of grain sales to the Soviet Union and thus undermine the President's commitment to help increase farm exports.
- Could be perceived as a weakening of U.S. sanctions imposed against the Soviets as a result of the Polish situation, and conflicting with the recent decision on sanctions on oil and gas equipment and technology.
- Could undermine ongoing U.S. efforts to enlist the support of its allies in restricting government credits to the Soviet bloc.

Option 3: Extend for two or more years the existing U.S.-U.S.S.R. grain agreement amended to provide higher minimum purchase requirements.

Advantages:

- Would insulate domestic consumers from possible Soviet disruption of U.S. markets for a longer period.

- Ensures higher minimum farm exports to the Soviet Union under all market conditions, demonstrating the President's commitment to increasing agricultural exports.

Disadvantages:

- Would signal a U.S. retreat from the sanctions imposed in response to the Polish situation and could undercut our efforts to secure changes in the policies of the Jaruzelski regime.

- Would undermine ongoing U.S. efforts to enlist the support of its allies in restricting government credits to the Soviet bloc. Our allies would view this option as inconsistent with the pipeline decision. It would damage our credibility with the allies on burden-sharing.

- Would broaden the no-embargo guarantee to higher amounts, enhancing the special treatment given to the Soviets.

Option 4: Negotiate a totally new U.S.-U.S.S.R. grain agreement.

Such an agreement might include four basic features:

1. A minimum purchase level for the grains covered under the agreement. The minimum purchase level would be adjusted each year on the basis of a two-year moving average of actual Soviet grain purchases.

2. A "prior consultation level" -- expressed as a percentage above the minimum purchase level -- beyond which the annual Soviet purchases could not go, without prior consultation with the U.S.

3. A provision to encourage the Soviets to buy value-added agricultural products.

4. A provision that any decision on supply availability above the prior consultation level would require commitments on both sides to purchase and sell specific amounts.

Under current international circumstances, it is highly unlikely that the Soviets would agree to a new agreement that would be viewed as an increase in U.S. leverage over Soviet affairs.

Advantages:

- Would achieve a greater integration of the U.S. and Soviet trading systems.

- Would assure U.S. farmers a reasonable share of the Soviet market, based on actual levels of grain trade.

- Would force the Soviets to be more forthcoming with respect to their buying intentions.

Disadvantages:

- Would signal a U.S. retreat from the sanctions imposed in response to the Polish situation, and could undercut our efforts to secure changes in the policies of the Jaruzelski regime.

- Would require protracted negotiations that could extend beyond the expiration of the current agreement.

- Would provide the Soviets much greater opportunity to press for stronger supply guarantee provisions.

APPENDIX

U.S.-SOVIET GRAIN TRADE 1973-1982

	Total USSR Grain Imports (mmt)	US Grain Exports to USSR (mmt)	US Share of Total USSR Grain Imports (%)
FY 1973	22.5	14.1	63
FY 1974	5.7	4.5	79
FY 1975	7.7	3.2	42
FY 1976	25.6	14.9	58
FY 1977	8.4	6.1	73
FY 1978	22.5	14.6	65
FY 1979	19.6	15.3	78
FY 1980	27.0	8.3	31
FY 1981	38.8	9.5	24
FY 1982 (projected)	45.0	13.9	31